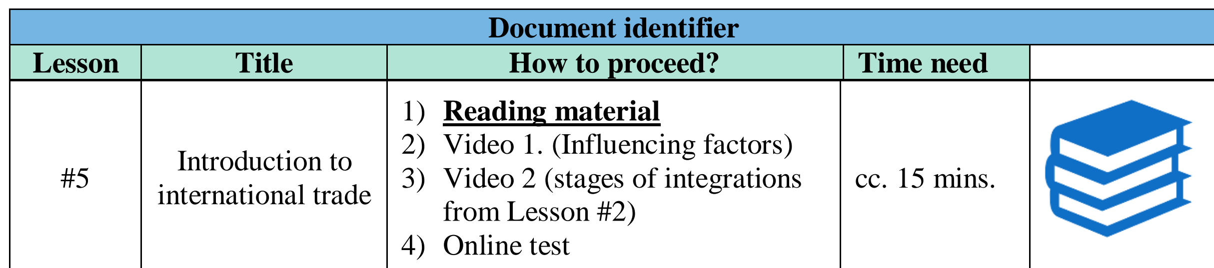
The EU in the Global Economy

Online learning



Document identifier				
Lesson	**Title**	**How to proceed?**	**Time need**	
#5	Introduction to international trade	1) **Reading material** 2) Video 1. (Influencing factors) 3) Video 2 (stages of integrations from Lesson #2) 4) Online test	cc. 15 mins.	

1 INTRODUCTION

In general, it is accepted that **international trade can contribute to economic development** which is strengthened by the basic macroeconomic logic. It is also accepted that **trade is an engine of growth**. The international community seems to accept that instead of aid countries should help developing countries participate in international trade. That is, many international organizations accept the idea of **"Trade not aid"**. The reason may be that trade promotes development and the country would not depend on external resources. Aid may cause dependency.

INTERNATIONAL TRADE AND ECONOMIC GROWTH

The basic macroeconomic equation is:

$$Y = C + I + G + X - IM.$$

This means that if a country can increase the exports while the other factors remain unchanged (ceteris paribus), there will be economic growth.

However, there is a relatively large debate whether trade actually contributes to economic development or not. The debate includes the following points:

Who can be the winners?	Only middle income countries can win from participating in international trade.
	Low income countries (that is, poor countries) only lose. They have to be stronger and export products with higher level value added, then they can be winners in international trade.
Countries dependent on tariffs	-There are some smaller countries (e.g. the small islands) where tariffs build a high proportion of a country's tax revenues. In some countries this proportion exceeds 25%. -Because of the liberalization process in the global economy, the average tariff levels is decreasing, that is, the revenue from tariff is becoming lower. This will result in reforms postponed due to the lower income.
Poverty reduction? Economic growth?	-The relationship between poverty reduction and participation in international trade to larger extent is higher than in the reality.
	-Poverty reduction (and economic growth) depends on more factors than only on the effectiveness of participating in international trade. (See China or the oil exporting countries as examples.)
Effects of trade agreements	Some bilateral trade agreements may have positive effects, but in some case trade preferences granted by trade agreements may have no impacts.
	-GSP scheme and the so-called EBA are highly criticized because the least developed countries could not gain from these preferences.

These factors show that it is not obvious that international trade promotes economic development in a country. It depends on many factors.

Influencing factors: Watch the related video!

2 TRADE POLICY

TRADE POLICY DEFINITIONS

Laws related to the exchange of goods or services involved in international trade including taxes, subsidies, and import and/or export regulations. (businessdictionary.com)
Trade policy defines standards, goals, rules and regulations that pertain to trade relations between countries.

Trade policy is in the hand of the government, specific to each country and formulated by its public officials. A country's trade policy includes taxes imposed on import and export, inspection regulations, and tariffs and quotas. It is used to achieve some **purposes:** to boost international trade and promote economic growth in the country or to increase tax revenues.

According the level of intervention, we distinguish between **two kinds of trade policies**:

1) **Liberal trade policy** refers to low level of tariffs and enables stronger competition in a country. Liberal trade policy leads to wider range of products in a country resulting in cheaper access. Furthermore, economies of scale can be beneficial for exporting companies. We must emphasize the minimum level of tariffs are used but trade restriction is not so strict as in the case of protectionist trade policy.

2) **Protectionist trade policy** imposes high tariffs and strict non-tariff barriers. This result in smaller competition in a country. Arguments for protectionist trade policy is the new-born industries and infant industries which are not strong enough to bear international competition and the government tries to protect for a certain period. Other arguments: to avoid pollution, to ensure sanitary issues or safety in the country.

Tools of trade policy:
1) Tariffs
2) Non-tariff barriers (NTB)

2.1. Tariffs

By definition, **tariff is tax which is imposed on goods which go through a border**. There are several types of tariffs:

Export tariff

-imposed on products exported to other countries. It is mainly imposed on cultural heritage or agricultural products to avoid hunger in the country.

Import tariff

imposed on products which come into the country. This is the most frequent type of tariffs.

Transit tariff

imposed on products going through a country but not sold there. E.g., if Serbia exports to the US through Hungary. Hungary as a transit country may impose a transit tariff.

Fiscal tariff

aims to improve the budget balance. Tariffs are taxes, so higher tariffs may improve the tax revenues and therefore the budget balance.

Prohibitive tariff

imposed to punish a country or to protect the domestic producers. Prohibitive tariffs are extremely high: they can exceed 200%.

The **logic of tariffs** can be understood very easily. Just assume that the price of a product equals to production cost. If there is no tariff, the producer can sell the product world price. If there is a tariff, this is a financial element, since tariff is a tax imposed on a product. The exporter must pay the tariff! (For instance, if the USA exports to the EU, the USA must pay tariff.) If the producer must pay an additional amount, it will be an additional cost resulting in increasing production costs. As a result, there will be an increase in product price. So, how can tariff restrict trade? The product becomes more expensive and the consumers will not buy it, and they will

> *Tariffs directly increase the product price*

prefer the cheaper domestic products to the more expensive imported goods! Since there is no or only decreasing demand for the product, trade will decrease.

The operations of tariffs

Assume that the production cost of 10,000 pencils is 18,500 USD. The USA wants to export 10,000 pencils to the EU. In case there is no tariff, the USA can sell 10,000 pencils on the price of 18,500 USD in the EU. In case there is tariff of 10%, the prices will be higher:

- 10% tariff: 18,500*0,1 = 1,850 USD
- USA must sell pencils at higher prices in order to cover the costs: 18,500 + 1,850 = 20,350 USD

As a result, pencils will be more expensive in the EU.

2.2. Non-tariff barriers

By definition, non-tariff barriers include every measure but not tariffs which aim to restrict or influence trade.

Main types on NTBs:

- **Quota** which restrict the quantity of goods. A certain quantity can be imported without any restriction, or a country may decide that a certain quantity can be imported freely, but above this quantity the exporter must pay tariff. Either the exporter, or the importer is responsible to get the necessary license.
- **Embargo** is a ban on the import.
- **Preferential trade agreements** give special rights to certain partners while others will be excluded.
- **Administrative prescribes** (sanitary, phytosanitary measures, environment, quality certifications): the exporter must prove that the exported goods totally comply with the national sanitary and quality rules. In order to prove it, the exporter must obtain and submit official documents.
- **Volunteer export restrain**: an importer country forces the exporter country to restrict its export to the importer country. That is, the exporter will decrease its export but not voluntarily due to the pressure of the importer country.
- **Subsidies** may distort the competition. Subsidies can be export subsidies: the producer receives financial assistance if the producer exports the product. The main aim of the subsidy is to help producer appear on the global market

EXAMPLES OF NTBS

Quota: quotas on US sugar imports: *„Imports of raw sugar are limited to about 3 billion pounds"*

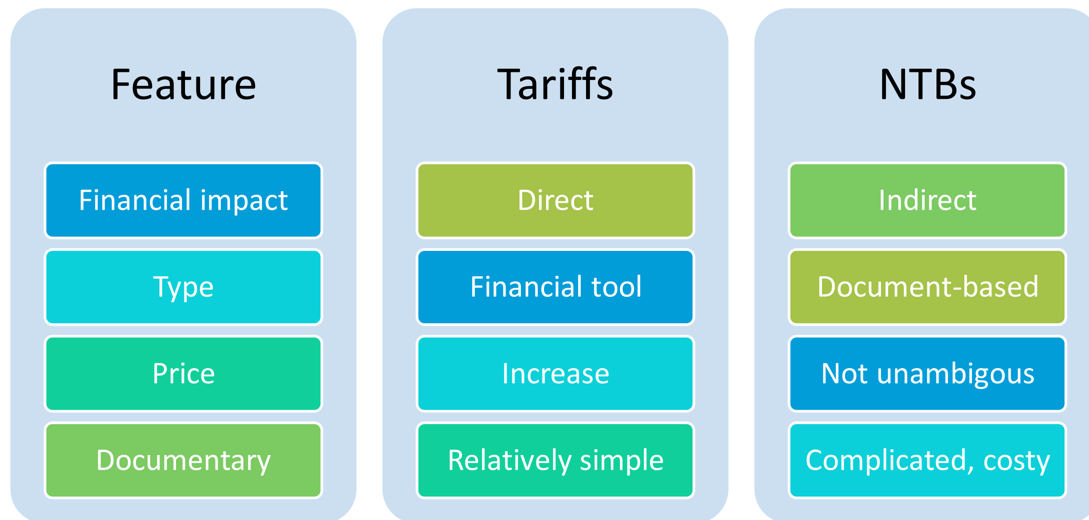
Embargo *„The US trade embargo on Cuba"*

Sanitary and phytosanitary measures: *„requiring products to come from a disease-free area, inspection of products, specific treatment or processing of products"*

VER: *„Japan imposed a VER on its auto exports into the US as a result of American pressure in the 1980s."*

with products not produced effectively. E.g. the world prices are lower than the cost of production and in order that the producers can cover the costs of production, the government provides subsidies.

3 COMPARISON OF TARIFFS AND NTBS



4 STAGES OF INTEGRATIONS

Creating integrations is mainly driven by the intense trade between partner countries. Most integrations between countries start with providing preferences for the most important trading partners, then the tariffs are eliminated, and, finally, the integration covers other areas besides trade. The more preferences are provided and the more areas covered in the integration, the deeper the integration is. Let's see the stages of integrations:

Stages of integrations: Watch the video in Lesson#2!

Trade area	**Preferential trade area**: participating countries provide preferential tariffs to each other.
	Free trade area: participating countries eliminate tariff restrictions but use different trade policies towards countries outside of the integration.
Market	**Common market**: there is no restriction on the free movement of labor, services, goods and capital (they are the so-called four freedoms).
	Single market: technical, financial and physical barriers are eliminated from the free movement of labor, services, goods and capital (e.g. there is no border control, there is tax harmonization).
Union	**Customs union**: participating countries eliminate tariff restrictions but use the same trade policies towards countries outside of the integration.
	Monetary union: participating countries use the same currency and have common monetary policy.

	Political union: A larger and consolidated group of nations or states that share a joint government that is internationally acknowledged.

5 FURTHER READING

https://www.wto.org/english/tratop_e/tariffs_e/tariffs_e.htm

https://www.wto.org/english/res_e/publications_e/wto_unctad12_e.pdf

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